

Moscow Financial Weekly

For the week ending May 16, 2003
Treasury Attache's office, U.S. Embassy Moscow

Highlights

- Fitch sovereign bond rating -- one level below investment grade
- First reading of Deposit Insurance bill delayed until June 4
- National Reserve Bank settles with Credit Agricole on forward contracts

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R30.8967	-0.66	-2.79
Monetary Base*	R1008.3 bln	-2.77	7.23**
CPI	NA	NA	6.2
International Reserves*	\$60.8 bln	1.50	27.46
RTS Index (end of week)	450.40	7.70	25.44
Refinancing rate	18	0	-3

*For week prior

** % chg from the abnormally high seasonal level at the end of the year.

Economic Developments

The Fitch agency has **upgraded Russia's long-term sovereign rating** in domestic and foreign currencies by two grades last week. The rating was increased from BB- to BB+ with a stable outlook. Currently, Russia is just one step away from investment-grade based on the Fitch scale and two steps away based on the scales of Moody's and S&P (see the table below). Fitch based its analysis on Russia's extremely good macroeconomic indicators, such as its favorable debt status, high liquidity and stable economic growth, which have led to an impressive increase in real incomes. Effective budget and economic policy has enabled the government to decrease the risks associated with its debt service, according to Fitch. Similar to other rating agencies, an investment grade rating is expected no sooner than 12 to 18 months from now. The new rating was already priced into the market, but could lead to even higher inflows of foreign capital.

For the week ending May 16, 2003

	S&P	Moody's	Fitch
Investment Ratings	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
Speculative ratings	BB+	Ba1	BB+*
	BB*	Ba2*	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-

*Russia's current rating

Banking sector

The intrigue around the **deposit insurance bill** continues. As was reported in a previous weekly, the first reading was rescheduled for May 14, but on the eve of that date, the bill was once again taken off the Duma's agenda, pursuant to a GOR request. The formal procedural reason for this delay was that the bill had to be considered as a package that would include all supporting amendments, in particular those to the Law on the Bank of Russia and to the Tax Code, as these amendments had not yet received required approval from the Committee on Budget and Taxes. However, on May 15, the Committee approved these amendments and once again recommended the deposit insurance bill for a first reading. The Duma Council subsequently scheduled the reading for June 4, leaving virtually no hope that the bill might be passed in all readings during the spring session, even if the session is extended until July.

According to *Vedomosti*, Vneshtorgbank and Evrofinance approached the CBR with a plan to create a holding company to buy the CBR's shares in two "roszagranbanks", **Moscow Narodny Bank (London) and BCEN-Eurobank (Paris)**. The Law on the Bank of Russia provides for divestiture of roszagranbanks (banks owned by the CBR that are chartered and operate abroad). The fact that the CBR owns these banks directly means that it does not need approval in the federal government budget before selling its shares, but National Banking Council would need to review the transaction. The CBR seems to be eager to divest as soon as possible, as it is selling its shares in roszagranbanks in other countries. At present, the CBR owns 15% in Donau Bank (Vienna), having sold the rest to VTB; a similar situation exists with East-West United bank (Luxembourg). The CBR still owns 51% of Ost-West Handelsbank AG (Frankfurt), but the process of selling it to VTB will likely continue. However, the CBR still owns 88.89% of MNB and 87.03% of Eurobank. There has been no progress in divestiture in these banks, primarily due to concerns of local regulators who believe that the banks will become more risky if the CBR is no longer the main shareholder. CBR First Deputy Chairman Oleg Vyugin does not rule out the possibility that the CBR may sell its stakes in MNB and Eurobank through a tender in 2004; however, the CBR also recognizes the concerns of the foreign

regulators. Before any sale takes place, PriceWaterhouseCoopers would offer an independent appraisal of MNB's and Eurobank's businesses, and then the CBR would enter into negotiations with bank supervisors from France and the UK. These negotiations may become the most difficult stage of the project, but Vyugin is rather optimistic regarding the timing and outcome of the negotiations. VTB and Evrofinance should consider the proper structuring of the holding company carefully in order to make a good impression on French and British supervisors, he said.

The "war" between **National Reserve Bank (NRB)** and Credit Agricole Indosuez has come to an end. It began in 1999 with the freezing of \$500 million-worth of NRB's assets after NRB refused to honor 14 forward contracts with Credit Agricole, made before the crisis, worth a total of around \$111 million. This action was followed by a series of court cases in several different countries. The current settlement reportedly provides for netting out mutual claims, unfreezing NRB's assets and mutual agreement not to sue further. In addition, NRB will have to pay Credit Agricole \$70 million within a year. Meanwhile, NRB Chairman Aleksandr Lebedev disavowed these reports on the terms of the settlement, but refused to disclose any information of his own on the matter. He also said that NRB is going to increase its capital to \$500 million by the end of 2003 through issuance of additional shares. Lebedev said that, now that the conflict with Credit Agricole is over, and that he will focus on building a holding company, NRB Group, with plans to invest in banking, energy, real estate, agriculture, and mass media. Lebedev also announced that the bank plans to become a major player in Russia's airline industry, and holds a 28% stake in Aeroflot.

According to CBR statistics, in March 2003 **Russian commercial banks imported \$119 million of cash dollars and exported \$260 million**. Since the CBR first started to publish such statistics in 1996, this was the first time that Russia's banks appeared to be net exporters of cash dollars. Bankers explain this by the general run on the dollar due to its weakening against both the euro and the ruble.

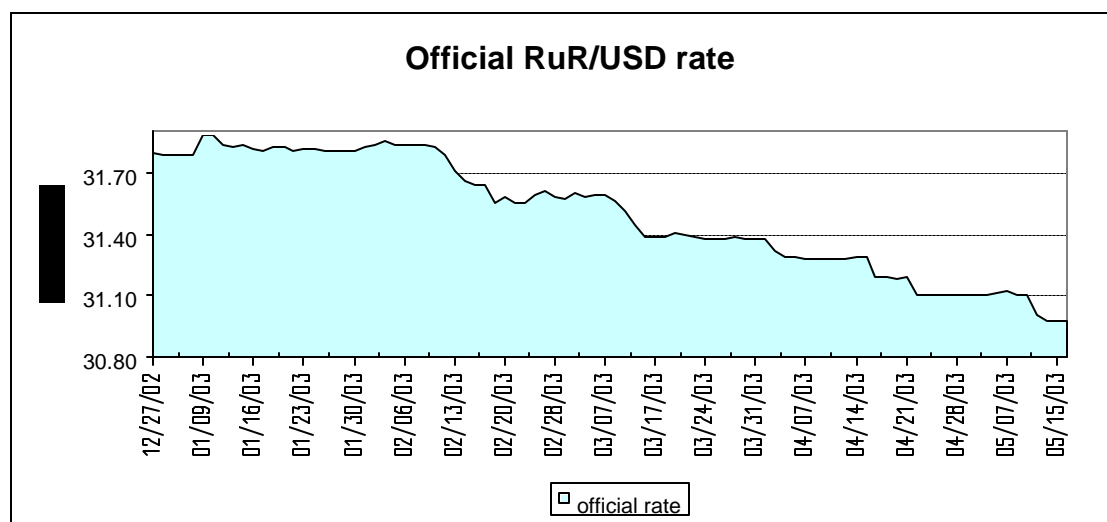
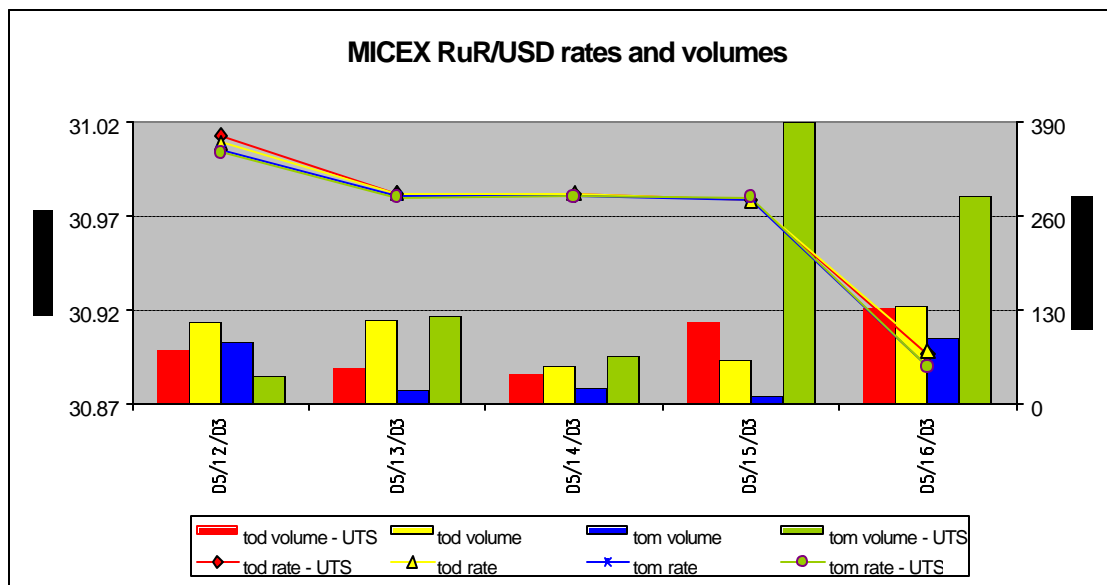
Financial markets

Forex Market

From the very opening of MICEX trading on May 12, the CBR, after having kept the ruble/dollar rate relatively stable around R31.10/\$ for almost three weeks, shifted its bid to R31.00/\$. The next day, the CBR, as virtually the sole remaining buyer of exporters' dollar revenues, moved its bid slightly further down, to R30.98/\$. However, on Thursday the downward pressure on the dollar/ruble rate increased, and the CBR was able to keep the official rate for the next day straight at R30.98/\$ only at the expense of tripling the scale of its intervention in the UTS-tom session while letting the averages in all other MICEX sessions slide below this point. On Friday the CBR retreated again, for the third time within one week, lowering its bid to R30.89/\$.

For the week the dollar weakened 0.66%, closing in the UTS on May 16 at R30.8967/\$. MICEX weekly trade volumes were \$412.22 million and \$479.30 million, \$230.00

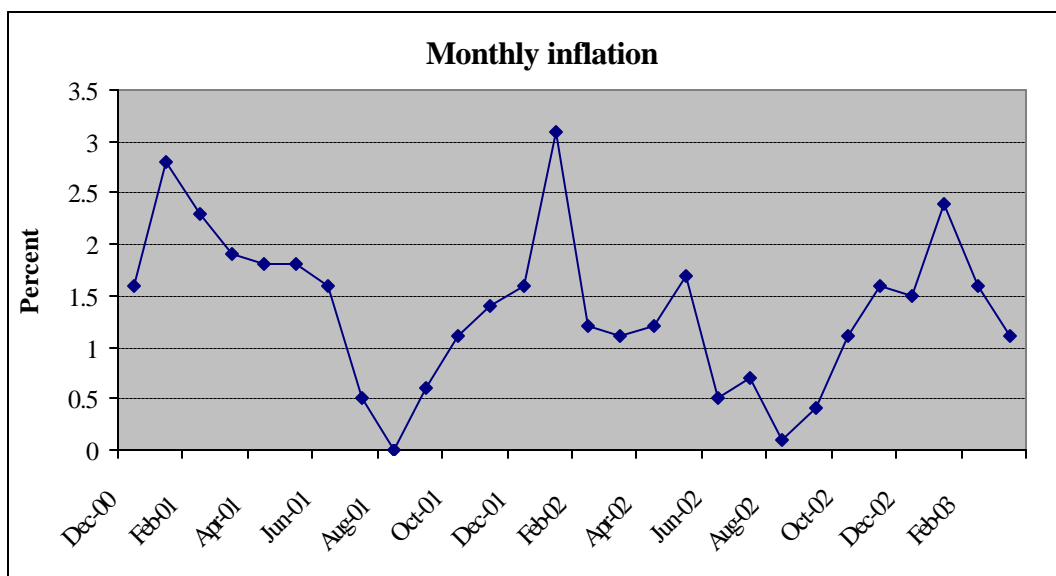
million and \$906.55 million for the morning (UTS) "tod" and "tom" sessions, and afternoon "tod" and "tom" sessions, respectively.



Prices

According to Goskomstat statistics, inflation was 1% in April, compared to 1.2% in April 2002. During the first four months of the year, prices increased by 6.2%; however, the monthly inflation rate in April was the lowest since the beginning of the year. The government's forecast for annual inflation in 2003 is 12%, but with annualized inflation

running at 14.6%, most observers expect that the GOR will be unable to meet its target because of continuing inflationary pressures in the economy.



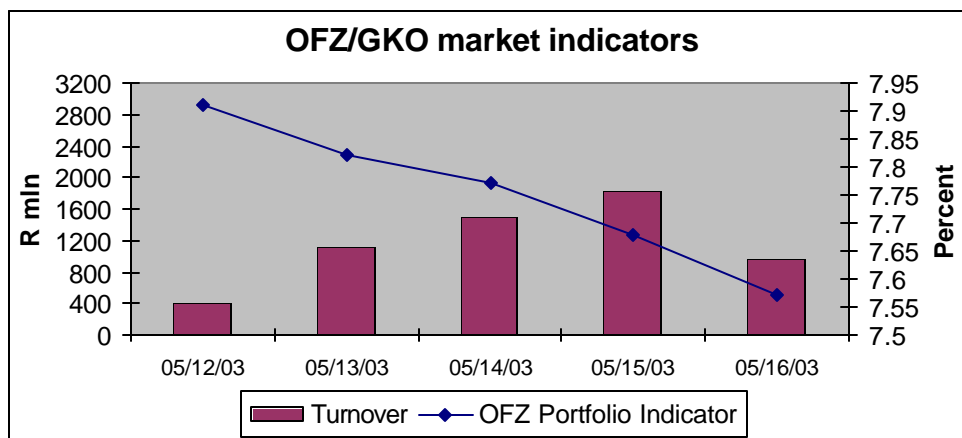
Eurobonds

The Russian Eurobond market continued to move upward and reach new highs. The Euro-30 hit a new maximum last week, with prices climbing to 94% of par. The market reacted quite positively to the Fitch upgrade, even though it was assumed to be priced into the market already.

Interest/Bond Market

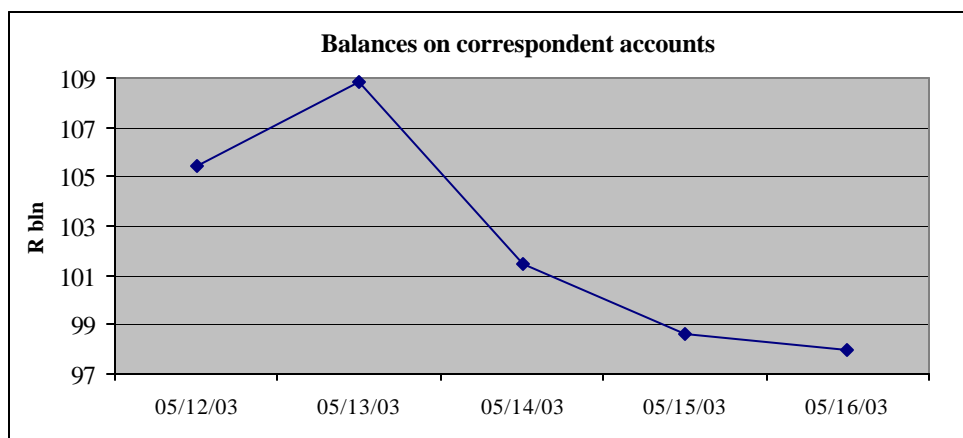
Bonds/Bills

The increasing saturation of rubles in the banking system, combined with ruble appreciation, were still, as usual, the main factors driving the gradual growth of the secondary OFZ/GKO market. Last week, yields fell more rapidly due to the announcement of the Fitch agency about Russia's sovereign upgrade. This growth was supported by increased activity among the market players.

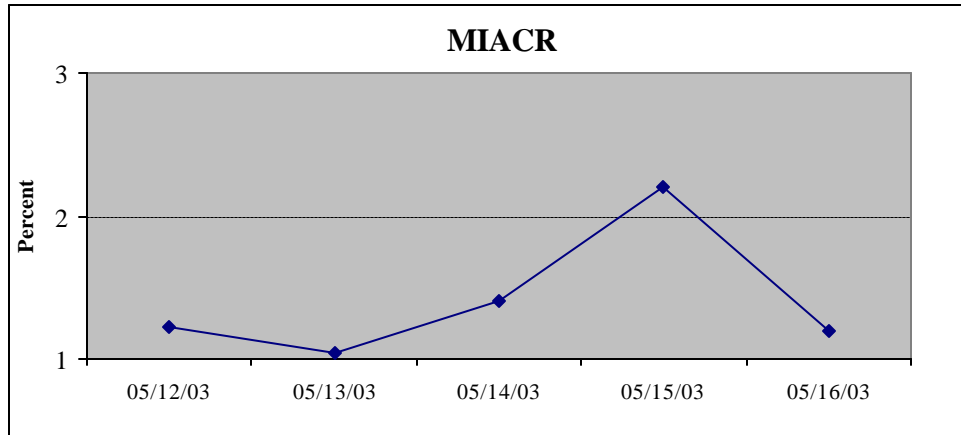


Overnight rates

The situation with the ruble liquidity somewhat stabilized after a shakeout during the Russian holiday period (May 1-2 and May 9). The balances on banks' correspondent accounts decreased from abnormally high levels down to relatively average levels by the end of the week, finishing on Friday at R98 billion. Overnight ruble interbank loan rates remained at the usual low levels, fluctuating in a narrow range.

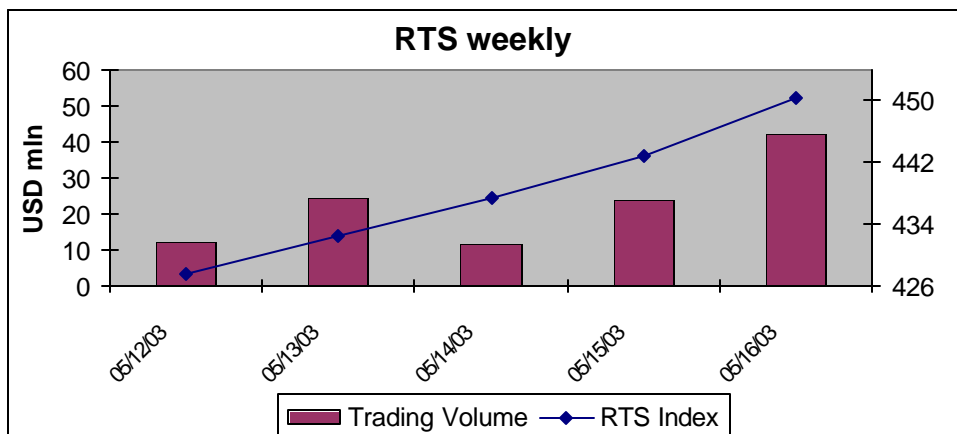


For the week ending May 16, 2003

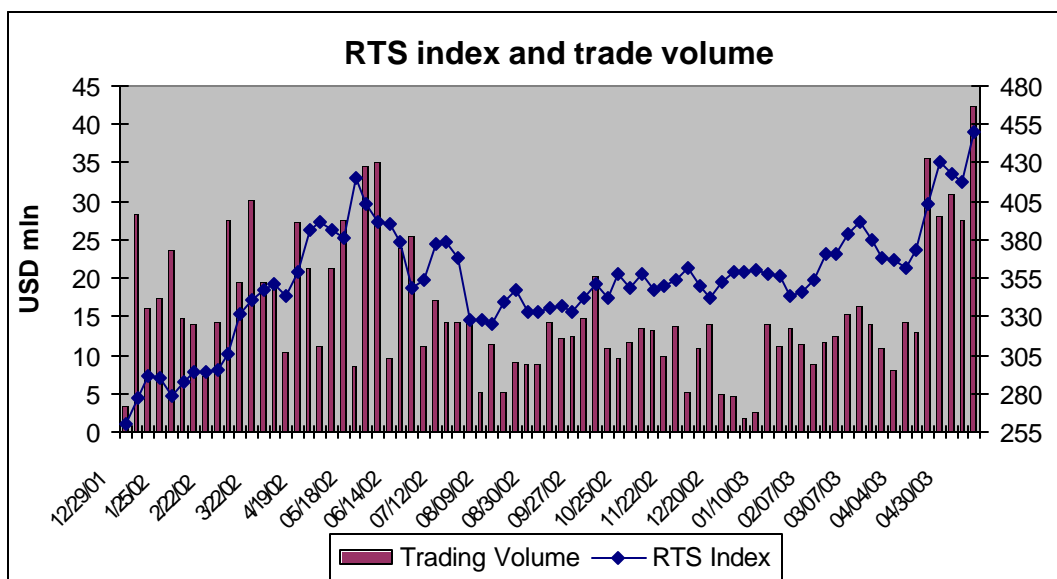
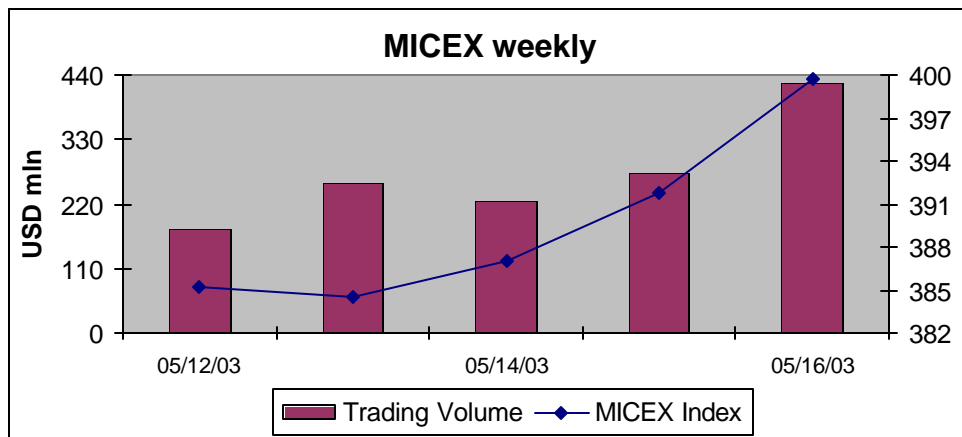


Stock Market

The stock market resumed its impressive growth after two weeks of slight downward corrections and Russian holidays. Increased liquidity, positive news from domestic companies, and stabilized oil prices were the main factors bringing optimism to the market. On Friday, the market was up considerably on volumes of up to \$42.5 billion. The leaders of growth were RAO UES shares, which increased by 15.2% for the week; YUKOS (up by 13.1%) and Sberbank (9.6%). Mosenergo experienced some downward corrections in response to growth the week before. The RTS index rose 7.7% in real terms for the week and is up by 25.44% since the beginning of the year.



For the week ending May 16, 2003

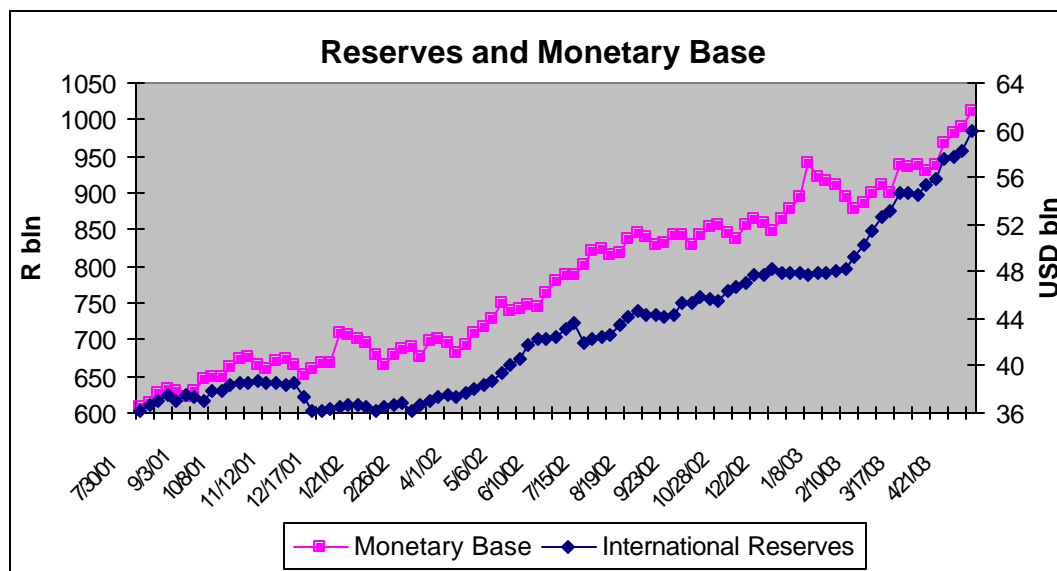


International Reserves and Monetary Base

The growth in the CBR's international reserves resumed during the week of May 5, hitting a new historic high of \$60.8 billion by the end of that week, an increase of \$900 million over the previous week. So far, the reserves have grown by \$13.1 billion in 2003, mainly as a result of high world oil prices.

The monetary base was down after a five-week period of growth and stopped at the level of R1008.3 billion as of May 12, 2003. This represents a R2.8 billion (2.77%) decrease for the week.

For the week ending May 16, 2003



EXPLANATORY NOTES

1. EXCHANGE RATES: SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS "tom" weighted average as of 11:30 becomes the "official" exchange rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

2. INTEREST RATES: Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

3. STOCK INDICES: The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

5. MONETARY BASE (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

6. LOMBARD CREDITS, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.